Central States Bankruptcy Workshop

Consumer Track

Separate Entity (LLC/Corp.) Issues

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CONCURRENT SESSION

2024

SEPARATE ENTITY (LLC and CORPORATIONS) ISSUES IN CONSUMER BANKRUPTCY

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Panelists:

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PART ONE:
EQUITY OWNERSHIP, MANAGEMENT AND THIRD PARTY STAY ISSUES

HYPOTHETICAL 1:
DELUXE DETAILING, INC.

Dan Debtor just lost a personal car accident case and a $1M judgment was entered. Dan files a **personal** Chapter 7 case. His primary asset is **100%** of the shares of Deluxe Detailing, Inc. – an Illinois corporation that he bought turnkey two years ago for $100,000 cash – that does car detailing and is Dan's sole source of income.

The only hard assets of the corpor"tion'are fully depreciated titled vehicles and non-titled equipment, which has been appraised auction value of $50,000. The corporation has no debt.

1. The vehicle that Dan Debtor drives is titled in the corporation. Can he claim an exemption in his personal bankruptcy case on the vehicle?

No

- *Fowler v. Shadel*, 400 F.3d 1016 (7th Cir. 2005)
- *In re Coenen*, 487 B.R. 539 (Bankr.W.D.Wisc. 2012)
- *In re Breece*, 487 B.R. 599 (6th Cir.BAP 2012)
- *See* Michael Joseph, *LLC Property Interests in an Individual Bankruptcy*, 12 **Norton Bankr.L.Adviser** 1 (2022)

<u>But See</u>

In re Ulz, 388 B.R. 865, 868 (Bankr.N.D.Ill. 2008) "Under Illinois law, ownership rights in property do not depend solely on formalities of title."

2. Dan Debtor was driving the corporate vehicle in the accident. Realizing that Dan Debtor is not collectable, the other driver is considering a lawsuit against Deluxe Detailing, Inc.

Does Dan Driver's personal bankruptcy stay actions against the corporation?

No

- *Proactive Measures USA LLC v. D'Angelo*, 2021 WL 5412533, 2021 U.S.Dist.LEXIS 227481(S.D.Ind. 2021)

- *In re Lengacher*, 485 B.R. 380 (Bankr.N.D.Ind. 2012)

- *In re White*, 415 B.R. 696 (Bankr.N.D.Ill. 2009)

- *In re Peoples Bankshares Ltd.*, 68 B.R. 536 (Bankr.N.D.Iowa 1986)

But See

- *In re 1600 Hicks Rd. LLC*, 649 B.R. 172 (Bankr.N.D.Ill. 2023) (Bankruptcy court has jurisdiction under Section 105 to stay actions in other courts, including suits to which the debtor need not be a party but which may **affect** the amount of property in the bankruptcy estate.)

3. Can the Chapter 7 trustee take over management of the corporation, including dissolve it?

Yes

- *In re Albright*, 291 B.R. 538 (Bankr.D.Colo.2003)

- *In re Modanlo*, 412 B.R. 715 (Bankr.Md. 2006)

- *In re Zoll*, 2012 WL 295168, 2012 Bankr. LEXIS 342 (Bankr.N.D.Ill. 2012)

Rule 9019 Compromise Option: Dan Debtor offers the Chapter 7 trustee a settlement, funded with a withdrawal from his exempt IRA.

4. Unable to make a deal with the Chapter 7 trustee, Dan converts the case to Chapter 13. What effect does the corporate ownership have on the liquidation analysis and projected disposable income?

- **Liquidation Analysis**: Hypothetical Chapter 7 Costs (Trustee commissions, accountant and other professionals of estate, tax consequences). Section 326(a).

- **Disposable Income**: Six months of prior wage/distribution history to calculate Current Monthly Income, monitoring of future income by the Chapter 13. Section 1322(d).

- Possible Post-confirmation modification if the corporate income improves. *See In re Powers*, 826 F.3d 962 (7th Cir. 2016). Section 1329.

HYPOTHETICAL 2:
FIVE GUYS PIZZA, LLC

Dan Debtor just lost a personal car accident case and a $1M judgment was entered. Dan files a personal Chapter 7 case. One of his assets is a 20% member interest in Five Guys Pizza LLC, an Illinois LLC which operates pizza restaurants, with four other members owning the other 80% member interests. Dan was the LLC manager until mid-2021, when he resigned on bad terms with the other members. Dan has not been involved in the operations since. He has a copy of the operating agreement and old tax returns, which have been provided to the Chapter 7 trustee, but not much else.

1. The operating agreement provides that any member that files a bankruptcy is automatically disassociated and the member interests revert to the LLC. Is this enforceable as to the Chapter 7 trustee?

No

- *In re LaHood*, 437 B.R. 330 (C.D.Ill. 2010)
- *In re Ehmann*, 319 B.R. 200 (Bankr.D.Ariz. 2005)
- *See* Section 541(c) which generally invalidates such ipso facto clauses.

2. The operating agreement is **very** restrictive. Can the Chapter 7 trustee sell the member interest **without** a right of first of first refusal to the other members, which is required under the operating agreement?

No

- *In re Capital Acquisitions & Management Corp.*, 341 B.R. 632 (Bankr.N.D.Ill. 2006)
- *In re Minton* 2017 WL 354319, 2017 Bankr.LEXIS 199 (Bankr.C.D.Ill. 2017)

But See

- Benjamin Waller & Rebecca Redwine, *Restrictions on the Transfer of LLC Membership Interests*, 42 **Am.Bankr.Inst.J.** 34 (2023

3. Are there any potential **benefits** to the Chapter 7 trustee due to the minority equity ownership being in an LLC rather than a regular corporation?

Yes: Many states allow a member to withdraw and compel purchase of the member's interest.

- *Sullivan v. Mathew*, 2015 WL 1509794, 2015 U.S.Dist.LEXIS 40033 (N.D.Ill. 2015)

- *See* materials from *The Intersection of Limited Liability Companies and Bankruptcy*, 23rd Annual Central States Bankruptcy Workshop (2016).

4. Dan Debtor converts his case to Chapter 11 and elects Subchapter V treatment. What are the reporting requirements as to the LLC in his Chapter 11?

- Periodic Reporting: Required financial reports for the entity, if available, using Official Form 426.

- Disposable Income: No means testing, so no six month of past income requirement. Section 1191(d).

5. Dan Debtor confirms a Subchapter V plan under Section 1191(b) with a set amount of "projected disposable income" over three years. The LLC has **outperformed** expectations and issues a $20,000 member disbursement to Dan Debtor. Can the Subchapter V trustee capture that income?

- Probably Not: Unlike a Chapter 13 case, only the **debtor** in a Subchapter V case is able to move to modify a confirmed plan. Section 1193(c).

PART TWO:

ALTER EGO, TRUSTEE STANDING, AND DENIAL OF DISCHARGE

Property of the Estate

When a bankruptcy petition is filed, an estate is created that consists of all property the debtor owns or in which the debtor has an interest.[1] *Property* is defined broadly and includes "all legal or equitable interests" of the debtor. As such, at the time of filing, "virtually all property of the debtor…becomes property of the bankruptcy estate."[2] The estate includes "every conceivable interest of the debtor, future, nonpossessory, contingent, speculative, and derivative."[3] And, except for a few and limited types of property set forth in 11 U.S.C. 541(a), property the debtor acquires after the petition is filed belongs to the debtor. Property of the estate is interpreted so broadly because the Code's goal is to "balance the equities in interest of all impacted parties involved in a bankruptcy case"[4].

Though federal law determines *when* a debtor's property interest becomes part of the bankruptcy estate, state law determines *if* a property interest even exists. The property rights in assets of a debtor's estate are determined by state law and "[u]nless some federal interest requires a different result, there is no reason why [property] interests should be analyzed differently".[5]

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[1] 11 U.S.C. §541(a)
[2] *In re Yonikus*, 996 F.2d 866, 869 (7th Cir.1993)
[3] See *Lincoln Office Supply Co. v. Taylor (In re Carousel Int'l Corp.),* 89 F.3d 359, 362 (7th Cir. 1996) (internal quotations and citations omitted); *see 5 Collier on Bankruptcy* § 541.08 (15th ed. rev. 2006).
[4] *In re Crawford*, No. BR 11-24158-SBB, 2012 Bankr. LEXIS 1163, 2012 WL 930281, at *23 (Bankr. D. Colo. Mar. 19, 2012)
[5] *Butner v. United States*, 440 U.S. 48, 54-55, 99 S.Ct. 914, 59 L.Ed.2d 136 (1979) and *Peterson v. McGladrey & Pullen, LLP*, 676 F.3d 594, 598 (7th Cir. 2012) ("The [Butner] Court held that state law defines the "property" that enters the bankruptcy estate, unless a provision in the Bankruptcy Code displaces state law.")

Alter Ego

Alter ego is an equitable remedy used to hold individuals that have misused a corporation (or other entity) accountable and though each state has its own requirements for use, it is based on the theory that the corporation was a "sham" and the alter ego of the shareholder, officer, or director. When the specific state requirements are met, creditors can "pierce the corporate veil" and hold the owner or officer - who would otherwise be shielded from corporate liability - personally liable. The idea being that if the shareholder, officer or director failed to treat the corporation as a separate entity, so can the corporation's creditors. Whether and under what circumstances veil-piercing is permitted, is a matter of state law. Likewise, whether and under what circumstances a bankruptcy trustee can pursue veil-piercing is a matter of state law.

When determining if a business and its owners are alter egos or the business is a mere "instrumentality" of the owner, courts may describe the factors considered differently, but they are by and large the same:

1) Were funds either siphoned/used by or co-mingled with those of an owner for personal benefit?
2) Was the company undercapitalized?
3) Were corporate formalities observed?
   a. Board meetings, books and records, "functioning" officers
4) Did the individual have so much control over business and finance policy or practice such that the entity had "no separate mind"

The alter ego theory may also be used to "*reverse* veil-pierce". Reverse veil-piercing is holding a corporation liable for a shareholder, officer or director's liabilities – or seeking to reach corporate assets to satisfy an owner's debts.[6]

Reverse veil-piercing can occur in two forms.: 1) inside – reaching business's assets for the benefit of an insider, and 2) outside – reaching business assets for the benefit of a third-party's creditors

[6] See *William Meade Fletcher et al., 1 Fletcher Cyclopedia of the Law of Corporations* § 41.70 (rev. vol. 2022).

or a bankruptcy trustee.[7] The crux of this, of course, is that the debtors themselves have some kind of property interest in the business. But, again, whether and under what circumstances the alter ego theory can be used to "*reverse* veil-pierce" is a matter of state law.

Illinois: Inside reverse veil-piercing is barred in Illinois, but, outside reverse veil-piercing is likely permitted under Illinois law.[8] The Seventh Circuit reasoned that Illinois courts have approved of non-traditional veil-piercing claims since the 1980s and neither the Illinois Supreme Court nor the Illinois State Legislature have yet disagreed.

Indiana: Indiana permits outside reverse veil-piercing. "[T]he separate existence of a corporation may be disregarded to prevent injustice when a third party transacts business with an individual who fraudulently uses a corporation as a shield from liability. To disregard the corporation's separate existence under the alter ego theory, the third party must show both ownership and control of the corporation by the shareholder." [9]

Iowa: Iowa permits outside reverse veil-piercing,[10] but does not permit insider reverse veil-piercing. The court rejected the 'reverse pierce" doctrine used to enable certain shareholders to pierce the corporate veil from within to reach individual benefits in cases involving insurance, probate, and real property."[11]

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[7] See *D.A.N. Joint Venture III, L.P. v. Touris*, 2023 U.S. Dist. LEXIS 175900, *20 (citing *In re Glick*, 568 B.R. 634, 659 (Bankr. N.D. Ill. 2017); *Reid v. Wolf* (*In re Wolf*), 2023 U.S. App. LEXIS 26813, *10.
[8] See *Reid v. Wolf* (*In re Wolf*), 2023 U.A. App. LEXIS 26813, *10.
[9] See *Lambert v. Farmers Bank*, 519 N.E.2d 745 (Ind. Ct. App. 1988) (citing *Hinds v. McNair* (1955), 235 Ind. 34, 58, 129 N.E.2d 553, 566).
[10] See *Benson v. Richardson*, 537 N.W.2d 748, 761 (Iowa 1995) ("Though typically employed to reach the assets of corporate owners to satisfy corporate liability, the alter ego doctrine is also a tool by which courts may satisfy the liabilities of individual owners with corporate assets.").
[11] *Hopper v. City of Waterloo*, No. 21-0047, 977 N.W.2d 115, 2022 Iowa App. LEXIS 197, 2022 WL 610321, at *7 (Iowa Ct. App. 2022) (unpublished).

Michigan: It does not appear that Michigan Courts permit reverse veil piercing in the creditor-debtor context: "The Sixth Circuit, however, has predicted that Michigan courts would not permit reverse veil piercing."[12] However, Michigan courts have recognized that it may be appropriate to invoke the doctrine for the benefit of a shareholder where the equities are compelling.[13]

Minnesota: Minnesota permits reverse veil piercing; the doctrine functions to prevent the defective legal form trumping substance. In Minnesota, the proponent must show that 1) the corporation was only the "alter ego" or of "instrumentality" of the principals and not governed by standard principals of accounting and business management, and 2) an element of injustice or fundamental unfairness would be fostered, a recognized statutory goal frustrated, or public policy violated, by giving effect to the corporate form.[14]

Missouri: There seems to be no guidance on the use of reverse veil piercing, but the Court suggests that insider reverse veil piercing, if available to majority shareholders should likewise be available to minority shareholders.[15] The Missouri Court of Appeals commented: "While this Court offers no guidance on the availability or acceptance of reverse veil piercing in Missouri, if the trend in other jurisdictions is to permit *majority shareholders* to pierce the corporate veil for their benefit in appropriate circumstances, then so, too, should minority shareholders be granted the authority to pierce the corporate veil in "appropriate circumstances."[16] It would appear that Missouri courts would allow reserve veil piercing, but have not had a case with facts that would allow it.

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[12] *Moyer v. Kooistra* (*In re Przybysz*), 2012 Bankr. LEXIS 6333, *25.
[13] *Wells v Firestone Tire & Rubber Co*, 421 Mich. 642, 651, 364 N.W.2d 670 (1984)
[14] See *In re Schuster*, 132 B.R. 604 (Bankr. D. Minn. 1991).
[15] *Hibbs v. Berger*, 430 S.W.3d 296, 309 (Miss. Ct. App. 2014)
[16] *Id.* at 309.

Ohio: Reverse veil piercing has not been adopted in Ohio. In fact, it has been specifically rejected as it "allows a judgment creditor to bypass the normal judgment collection procedure of attaching the judgment to the debtor's shares in the corporation, and instead attach the corporate assets directly."[17]

Wisconsin: In Wisconsin, reverse veil-piercing is permitted "when the controlling party uses the controlled entity to hide assets or secretly to conduct business to avoid the pre-existing liability of the controlling party." [18]

Trustee's Standing

Section 704 of the Bankruptcy Code sets forth the trustee's powers and duties. Like section 541, section 704 is interpreted broadly. The trustee represents the rights of a debtor, but also the interests of his creditors. Pursuant to 11 U.S.C. § 544, the trustee may "step into the shoes" of a creditor and bring a suit to recover or reach property available under state law to distribute to all creditors, equally.[19] Section 544 authorizes the trustee to assert any cause of action based upon a general injury to the debtor's creditors; that is, the trustee may assert a cause of action derivatively of creditors' rights to do so if the allegations "could be asserted by any creditor." [20] However, "[a] variety of fact patterns, difficult or nonexistent state law and not altogether consistent interpretations of state law by federal courts have produced a patchwork of reported decisions addressing whether a bankruptcy trustee has standing to disregard corporate

[17] See *Wick v. Ach*, 1st Dist. Hamilton No. C-180243, **2019-Ohio-2405**, ¶ **5**, 139 N.E.3d 480 (citing *Gershuny v. Gershuny*, 1st Dist. Hamilton No. C-140482, 2015-Ohio- 4454, ¶ 14.).
[18] *Olen v. Phelps,* 200 Wis. 2d 155, 163, 546 N.W.2d 176 (Ct. App. 1996).
[19] *Koch Refining v. Farmers Union Central Exchange, Inc.*, 831 F.2d 1339, 1348 (7th Cir. 1987).
[20] *See Fisher v. Apostolou*, 155 F.3d 876, 879 (7th Cir. 1998) (quoting *Koch Refining v. Farmers Union Central Exchange, Inc.*, 831 F.2d 1339, 1348 (7th Lir. 1987)).

form in an action to reach the assets of a nondebtor or to hold a nondebtor responsible for debts of the debtor."[21]

In Wisconsin, Illinois and Indiana, a bankruptcy trustee has standing to bring an alter ego claim that may otherwise belong to creditors.[22]

In Minnesota, reverse veil piercing is not available to creditors; but is instead limited to one with a property interest in the corporation itself – the ownership interest.[23] Therefore, in Minnesota, the trustee has standing to bring an alter ego claim and reverse veil pierce if the estate has an interest in the business either by virtue of the debtor holding it on the petition date, or as the result of an avoidance action. In *Schuster*, the debtor transferred his 50% interest in the company to his wife (the other 50% owner) during the pre-Petition period. The trustee first avoided that transfer and brought the 50% interest back into the estate. Without this prior avoidance, the Court concluded, the trustee would not have had standing under the Eight Circuit's holding in *In re Ozark*[24]. In *Ozark*, the Eight Circuit rejected the use of 11 U.S.C.§§ 704 and 541, 11 U.S.C.§ 544, and 11 U.S.C.§ 105 to provide the trustee with standing to bring an alter ego action against the principals of the corporate debtor. *Ozark* involved the application of Arkansas law, which provides that the alter-ego remedy belonged to a corporation's creditors, and so was personal to the corporate creditors and did not run to the corporation. The rationale in *Ozark* has been criticized, but remains good law in the Eighth Circuit.

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[21] *Limor v. Buerger* (*In re Del-Met Corp.*), 322 B.R. 781, 830 (Bankr. M.D. Tenn. 2005).
[22] *Koch Refining v. Farmers Union Central Exchange, Inc.*, 831 F.2d 1339, 1346 (7th Cir. 1987) ("This court previously recognized the bankruptcy trustee, representing creditors, as the proper party to bring an alter ego claim under Wisconsin law. We now find that, under Illinois and Indiana law as well, a bankruptcy trustee can bring an alter ego claim of action.")
[23] See *In re Schuster* 132 B.R. 604, 608-609 (Bankr. D. Minn. 1991).
[24] *In re Ozark Restaurant Equipment Co.*, 816 F.2d 1222 (8th Cir. 1987).

Michigan law would not permit the bankruptcy trustee from asserting a claim based upon alter ego. The court concluded that, in Michigan, the alter ego remedy is "akin" to causes of action belong to specific creditors and, therefore, 11 U.S.C. § 544(a) would not permit the trustee to assert it.[25]

Because there is no uniform answer to whether a trustee has standing to bring an action that utilizes the alter ego or veil piercing theories, you must look to state law.

Denial of discharge

Section 727(a)(2)(A) of the Bankruptcy Code provides for discharge unless the debtor, with the intent to hinder, delay, or defraud a creditor or officer of the bankruptcy estate has transferred, removed, destroyed, mutilated, or concealed, or, has permitted the transfer, removal, destruction, mutilation, or concealment of property of the debtor within one year before filing.[26]

Whether a debtor's actions with respect to property of his alter ego can give rise to a denial of discharge under 11 U.S.C. § 727(a)(2)(A) depends on the court. Some courts apply their respective state's law on alter ego and support the extension of section 727(a)(2)(A) by recognizing the nature of bankruptcy courts as courts of equity, applying or extending existing precedent and looking at recognizing that the "transfer", as defined in 11 U.S.C. §101(54)(D) specifically includes indirect transfers.[27]

Other courts do not read section 727(a)(2) as extending to property of entities other than the debtor. These courts support this narrow reading of section 727 by pointing to 1) the lack of

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[25] *Moyer v. Kooistra* (*In re Przybysz*), 2012 Bankr. LEXIS 6333, *25.
[26] 11 U.S.C. §727(a)(2)(A)
[27] See 11 U.S.C. §101(54) (The term "transfer" means— (A) the creation of a lien; (B) the retention of title as a security interest; (C) the foreclosure of a debtor's equity of redemption; or (D) each mode, direct or indirect, absolute or conditional, voluntary or involuntary, of disposing of or parting with— (i) property; or (ii) an interest in property.)

textual support for alter ego theories in the statute, 2) the language of the statute seems to suggest that the debtor's interest must be direct, 3) the availability of other remedies, and, 4) limitation of the bankruptcy court's equitable powers by the text of the Bankruptcy Code.[28]

The Seventh Circuit, in *In re Snyder*[29], upheld the denial of debtors' discharge under section 727(a)(2) when, while in a chapter 11 (prior to conversion to chapter 7) a debtor used his own farm equipment, leased farm land for less than fair market value, and continued to farm for the benefit of two corporations owned by family members. The Court found that the debtors' stark reduction in income while the two corporations grew substantially to be "indicative of a scheme through which the debtors 'ceased making payments on their debts, while retaining through their family a highly profitable farming operation."[30]

However, there is a dispute among bankruptcy courts within the Seventh Circuit as to the application of *Synder* to pre-Petition activity. In 2014, one bankruptcy court in the Northern District of Illinois found that alter ego theories are incompatible with the text of section 727(a)(2)(A)[31], but in 2021, another bankruptcy court found that "*Synder* directly supports the proposition that a debtor's fraudulent manipulation of the assets or cashflows of his businesses may come within the scope of section 727(a)(2)(A)."[32] Reading sections 727(a)(2)(A) and 101(54)(D), the court found that "the provisions dictate that a business-owning debtor who (in his corporate capacity) fraudulently transfers assets or cashflows out of his businesses violates section 727(a)(2) because he is also permitting (in his personal capacity) an indirect alienation of

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[28] *Vara v. Motil* (*In re Motil*), 2023 Bankr. Lexis 102, *13, 2023 WL 187156.
[29] See *In re Snyder*, 152 F.3d 596 (7th Cir. 1998)
[30] *Id.* at 599.
[31] See *Trivedit v. Levine* (*In re Levine*), 2014 Bankr. LEXIS 5161, 2014 WL 7187007, at 3-5 (Rejecting the application of the alter ego theory to section 727(a)(2)(A) due to text of the section, and recognizing that congress created other remedies for dealing with fraudulent transfers such as sections 548 and 544(b).)
[32] See *Villa Oaks, LLC v. Shakir* (*In re Shakir*), 623 B.R. 532, 540 (Bankr. N.D. Ill. 2021).

property interests (the value of his ownership interest) that would otherwise belong to the estate."[33]

There is no binding precedent in the Sixth Circuit, but at least one bankruptcy court in the Northern District of Ohio, believes that in section 727(a)(2), "property of the debtor" is limited to property actually owned by the debtors "and not to property that under equitable principals could at some point be determined to be property of the debtor." This court went on: "[e]quitable concerns about a debtor getting away with fraudulent activity could well serve as red herrings given the availability of other penalties, such as criminal liability, avoidance actions, and the nondischargeability of certain debts under § 523(a)…"[34]

In the Eight Circuit, for the purposes of section 727(a)(2), the property at issue must be owned by the debtor.[35] In *Wagner*, the Court notes, "[a]rguments to the contrary simply fail to consider the language employed by Congress in the adoption of 11 U.S.C. § 727(a)(2)(A). Had Congress intended to include the transfer of property of another entity, it could have included that, but the language in subsection (2)(A) is sufficiently clear to eliminate such an interpretation." [36]

However, a debtor can still lose his discharge under section 727(a)(2) if he transfers property from his business if he does so to intentionally devalue his own business interest.[37] In *Burg*, the Debtor transferred, removed, destroyed, or concealed his business's assets and financial records in order to: 1) manipulate the debt service coverage ratio; 2) deplete the

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[33] *Id.*
[34] See *Vara v. Motil* (*In re Motil*) (Despite the court's reluctance to apply alter ego theories to claims under sec. 727(a)(2), the court declined to dismiss the claim at the pleadings stage.)
[35] *Northeast Neb. Econ. Dev. Dist. v. Wagner* (*In re Wagner*), 305 B.R. 472 (B.A.P. 8th Cir. 2004).
[36] *Id.* at 476 (citations omitted).
[37] *In re Burg*, 2023 Bankr. LEXIS 3055

business's assets; 3) divert the business's assets to himself, an insider, and affiliates of an insider; 4) avoid paying a creditor amounts due and owing under the note; and 5) conceal the evidence of his fraudulent scheme.[38] The court denied the debtor's discharge under section 7272(a)(2)(A) finding that destroyed his own property – the stock on his company – with the intent to hinder, delay or defraud creditors.

[38] *Id.* at 21-22

PART THREE:

OWNERSHIP OF TAX REFUNDS AND OTHER RELATED ISSUES

DELUXE DETAILING, INC.

Dan Debtor, the **100%** owner of Deluxe Detailing, Inc. – an Illinois corporation – has elected Subchapter S treatment for the corporation. Because the corporation has significant losses, this has resulted in Dan receiving a $50,000 refund. Deluxe Detailing files for chapter 7 relief.

1. Is Deluxe Detailing's chapter 7 trustee entitled to the refund?

No

- *Official Comm. of Unsecured Creditors of Forman Enters., Inc. v. Forman (In re Forman Enterprises, Inc.)*, 281 B.R. 600 (Bankr. W.D. Pa. 2002).
- *In re Redf Mktg., LLC,* 589 B.R. 539 (Bankr. W.D.N.C. 2018)
- *Borton & Sons, Inc. v. United States*, 2013 U.S. Dist. LEXIS 47739 (E.D. Wash. April 2, 2013).

2. May the Trustee of Deluxe Detailing withdraw the Subchapter S election in an effort to capture the expected tax refund for the year of the case filing and the use of the NOLs for the benefit of Deluxe Detailing's estate?

No

- *Majestic Star Casino, LLC v. Barden Dev., Inc. (In re Majestic Star Casino, LLC)*, 716 F.3d 736 (3d Cir. 2013).

Yes

- *In re Trans-Lines West, Inc.*, 203 B.R. 653 (Bankr. E.D. Tenn. 1996).

- *Halvorson v. Funaro (In re Funaro)*, 263 B.R. 892 (Bankr. App. P. 8th Cir. 2001).

- *Parker v. Saunders (In re Bakersfield Westar, Inc.),* 226 B.R. 227 (Bankr. App. P. 9th Cir. 1998).

3. Pre-bankruptcy, Dan decides to waive an NOL carryback passed through to Dan from Deluxe Detailing. The effect of this decision is to reserve the NOLs for future use and avoid receiving a $50,000 pre-petition tax refund. May the Trustee of Deluxe Detailing pursue a fraudulent transfer claim to unwind the waiver and claim the refund?

Yes

- *Harker v. IRS (In re Citro)*, 2018 Bankr. LEXIS 4278 (Bankr. S.D. Ohio 2018)

4. The Trustee of Deluxe Detailing sells its assets creating capital gain for Dan. May Dan withdraw the subchapter S election so as to avoid paying the tax and shifting it to the Deluxe Detailing estate?

Yes

- *Majestic Star Casino, LLC v. Barden Dev., Inc. (In re Majestic Star Casino, LLC)*, 716 F.3d 736 (3d Cir. 2013).

No

- *In re Vital Pharms.*, 655 B.R. 374 (Bankr. S.D. Fla. 2023).

5. Dan files his own bankruptcy case and does not disclose the existence of a Paycheck Protection Program loan that he took out during the pandemic or that he fraudulently obtained the loan. Will this cause problems in his bankruptcy case?

Yes

- *In re Gaylor*, 656 B.R. 412 (Bankr. E.D. Mich. 2023) (court dismissed chapter 13 case for failure to disclose PPP loan and the fact it was fraudulently obtained).

- *In re Davis,* 2023 Bankr. LEXIS 2861 (Bankr. E.D. Mich. 2023) (discharge denied due to fraudulently obtained PPP loan).

- *In re Corinthian Commc'n, Inc.*, 642 B.R. 224 (Bankr. S.D.N.Y. 2022) (court expanded subchapter V trustee's duties in part based upon PPP loan fraud).

Faculty

Sumner A. Bourne is a partner with Rafool & Bourne, P.C. in Peoria, Ill., where he primarily represents debtors in chapter 7, 11 and 13 cases, and has confirmed several subchapter V plans. He also is a subchapter V trustee in downstate Illinois, accepting trustee appointments in the Central and Southern Districts of Illinois. Mr. Bourne has experience in representing chapter 7 trustees in preference and other asset-recovery litigation. He is a past chair of the Illinois State Bar Association's section on Bankruptcy practice, and he is a frequent lecturer on bankruptcy issues, having presented for ABI, the Illinois State Bar Association (ISBA), the office of the Illinois Attorney General and the National Association of Bankruptcy Trustees (NABT), among other organizations. Mr. Bourne is a frequent author on bankruptcy issues, most recently focusing on subchapter V, and has been published in the *ABI Journal* and the journal of the NABT. He received his B.S. from the University of Illinois in 1990 and his J.D. *magna cum laude* in 1994 from Boston University School of Law.

Hon. Daniel S. Opperman is the Chief U.S. Bankruptcy Judge for the Eastern District of Michigan in Bay City, sworn in on July 13, 2006, and reappointed in 2020. He also served for six years on the Bankruptcy Appellate Panel for the Sixth Circuit and was its Chief Judge for two years. Prior to taking the bench, Judge Opperman practiced with Braun Kendrick Finkbeiner, where he concentrated in litigation, bankruptcy and real estate. He earned his B.S. *magna cum laude* from Eastern Michigan University and his J.D. *magna cum laude* from Wayne State University Law School, where he was a member of the *Wayne Law Review* and served as note and comment editor. He currently is a trustee of the Eastern Michigan University Foundation.

Nicole I. Pellerin is a shareholder with Murphy Desmond Lawyers S.C. in Madison, Wis., and co-chair its Creditor Rights, Business Bankruptcy & Commercial Litigation Practice Group. She focuses her practice on bankruptcy, insolvency litigation and probate matters, and she represents individual and business debtors and creditors in all chapters of bankruptcy and other insolvency proceedings, including creditors' committees in chapter 11. In addition, she has represented chapter 7 trustees across Wisconsin and receivers in state court receiverships. In 2018, Ms. Pellerin was appointed to the Panel of Chapter 7 Trustees for the Western District of Wisconsin. She has served as a panel trustee in the Western District of Wisconsin, as well as the Northern District of Illinois, and in this capacity serves clients in probate matters. Ms. Pellerin is a member of various bankruptcy organizations, and she previously served as associate editor of the *American Bankruptcy Trustee Journal*, a publication of the National Association of Bankruptcy Trustees. She is named in *The Best Lawyers in America* for Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law, as well as in *Wisconsin Super Lawyers* for Creditor/Debtor Rights, and she is a member of ABI, the National Association of Bankruptcy Trustees and the Wisconsin Bar Association. Ms. Pellerin received her B.A. in psychology from the University of Texas at Austin and her J.D. from Chicago-Kent College of Law.

Catherine L. Steege is a partner with Jenner & Block LLP in Chicago and co-chairs the firm's Bankruptcy and Restructuring practice group. She focuses her practice on representing committees, debtors, contract counterparties, creditors, trustees and examiners in complex chapter 11 cases and related out-of-court restructurings and litigation. Ms. Steege recently represented USA Gymnastics

in its chapter 11 case and represented McKesson and an ad hoc group of other major distributors, pharmacies and manufacturers in Purdue Pharma's and Endo's chapter 11 cases. In addition to a traditional bankruptcy practice, she has represented numerous retiree committees, including the retiree committees in the Puerto Rico, Armstrong Flooring, Budd Company, Walter Energy, American Airlines, United Airlines and Northwest Airlines chapter 11 cases, and she has represented numerous parties in complex bankruptcy litigation matters, including her representation of the Zell defendants in the Tribune fraudulent conveyance litigation, the Sentinel Management Group Litigation Trustee, the Magnatrax Litigation Trust, the NKK Litigation Trust, and the Trustees of Emerald Casino Inc. and Consolidated Industries Corp. Ms. Steege has an active appellate practice and argued in the U.S. Supreme Court on behalf of Wellness International Network in the case of *Wellness International Network v. Sharif* and represented the petitioner in *Law v. Siegel* and the respondent in *City of Chicago v. Fulton*. She also represented the examiners in the Lehman Brothers and Celsius Network chapter 11 cases, and she authored the sections of the Lehman Brothers Examiner's Report that considered potential avoidance actions against various financial institutions. Ms. Steege is a Fellow of the American College of Bankruptcy and a member of the National Bankruptcy Conference, and she taught bankruptcy law for 22 years at The University of Illinois Chicago John Marshall Law School. She was listed in *The Best Lawyers in America* for Bankruptcy and Creditor/Debtor Rights/Insolvency and Reorganization Law, Litigation and Bankruptcy from 2007-21 and for 2024, in *Chambers USA* for Bankruptcy/Restructuring from 2008-23, and in *Illinois Super Lawyers* from 2005-24. Ms. Steege received her B.S.J. in 1978 from Northwestern University and her J.D. in 1982 with honors from DePaul University.